

**ASSEMBLY BILL**

**No. 1761**

**Introduced by Committee on Insurance (Vargas (Chair),  
Calderon, Karnette, Lieber, Nava, and Umberg)**

March 16, 2005

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An act to add Section 1033.5 to the Insurance Code, relating to insolvency.

LEGISLATIVE COUNSEL'S DIGEST

AB 1761, as introduced, Committee on Insurance. Insolvency: deductible agreements.

Existing law generally regulates the liquidation of insolvent insurers. Existing law establishes the California Insurance Guarantee Association for purposes related to the payment of covered claims of certain insolvent insurers.

This bill would prohibit any collateral held by or for the benefit of, or assigned to, an insurer or liquidator pursuant to these provisions to secure the obligations of a policyholder under a deductible agreement, as defined, from being considered an asset of the estate of the insolvent insurer. The bill would impose certain requirements on the liquidator and the policyholder with respect to the payment of claims from this collateral, and would specify the obligations of the California Insurance Guarantee Association, or another guaranty association, regarding claims covered by this collateral.

Vote: majority. Appropriation: no. Fiscal committee: no.  
State-mandated local program: no.

*The people of the State of California do enact as follows:*

1 SECTION 1. Section 1033.5 is added to the Insurance Code,  
2 to read:

1 1033.5. (a) Notwithstanding any other provision of law or  
2 contract to the contrary, any collateral held by or for the benefit  
3 of, or assigned to, the insurer or the liquidator to secure the  
4 obligations of a policyholder under a deductible agreement shall  
5 not be considered an asset of the estate and shall be maintained  
6 and administered by the liquidator as provided in this section.

7 (b) If the collateral is being held by or for the benefit of, or  
8 assigned to, the insurer or the liquidator to secure obligations  
9 under a deductible agreement with a policyholder, the collateral  
10 shall be used to secure the policyholder's obligation to fund or  
11 reimburse the payment of claims within the agreed deductible  
12 amount.

13 (c) If a claim that is subject to a deductible agreement and  
14 secured by collateral is not covered by a guaranty association or  
15 the California Insurance Guarantee Association and the  
16 policyholder is unwilling or unable to take over the handling and  
17 payment of the noncovered claims, the liquidator shall adjust and  
18 pay the noncovered claims utilizing the collateral, but only to the  
19 extent the available collateral, after allocation under subdivision  
20 (d), is sufficient to pay all outstanding and anticipated claims. If  
21 the collateral is exhausted and the policyholder is not able to  
22 provide funds to pay the remaining claims within the deductible  
23 after all reasonable means of collection against the policyholder  
24 have been exhausted, the remaining claims shall be claims  
25 against the insurer's estate, subject to the other provisions of this  
26 article regarding the filing and allowance of claims. When the  
27 liquidator determines that the collateral is insufficient to pay all  
28 additional and anticipated claims, the liquidator may file a plan  
29 for equitably allocating the collateral among claimants, subject to  
30 court approval.

31 (d) (1) To the extent that the liquidator holds collateral  
32 provided by a policyholder that was obtained to secure a  
33 deductible agreement and to secure other obligations of the  
34 policyholder to pay the insurer, directly or indirectly, amounts  
35 that become assets of the estate, such as reinsurance obligations  
36 under a captive reinsurance program or adjustable premium  
37 obligations under a retrospectively rated insurance policy or  
38 where the premium due is subject to adjustment based upon  
39 actual loss experience, the liquidator shall equitably allocate the

1 collateral among those obligations and administer the collateral  
2 allocated to the deductible agreement pursuant to this section.

3 (2) With respect to the collateral allocated to obligations under  
4 the deductible agreement, if the collateral secured reimbursement  
5 obligations under more than one line of insurance, then the  
6 collateral shall be equitably allocated among the various lines  
7 based upon the estimated ultimate exposure within the deductible  
8 amount for each line.

9 (3) The liquidator shall inform the guaranty associations or the  
10 California Insurance Guarantee Association that is or may be  
11 obligated for claims against the insurer of the method and details  
12 of each allocation made pursuant to this subdivision.

13 (e) (1) Regardless of whether there is collateral, if the insurer  
14 has contractually agreed to allow the policyholder to fund its own  
15 claims within the deductible amount pursuant to a deductible  
16 agreement, either through the policyholder's own administration  
17 of its claims or through its provision of funds directly to a third  
18 party administrator who administers the claims, the liquidator  
19 shall allow the funding arrangement to continue and, where  
20 applicable, shall enforce the arrangement to the fullest extent  
21 possible. The funding of any of these claims by the policyholder  
22 within the deductible amount, including, but not limited to, any  
23 of these claims by the policyholder or the third party claimant,  
24 shall bar a claim for that amount in the liquidation proceeding.

25 (2) The funding of claims pursuant to paragraph (1) shall  
26 extinguish the obligation, if any, of a guaranty association or the  
27 California Insurance Guarantee Association to pay the claims  
28 within the deductible amount, as well as the obligation, if any, of  
29 the policyholder or third party administrator to reimburse the  
30 guaranty association or the California Insurance Guarantee  
31 Association. No charge of any kind shall be made by the  
32 liquidator against any guaranty association or the California  
33 Insurance Guarantee Association on the basis of the policyholder  
34 funding of claims payment made pursuant to the mechanism set  
35 forth in this subdivision. The funding of these claims by the  
36 policyholders shall not limit or prejudice any right the guaranty  
37 association or the California Insurance Guarantee Association  
38 may have with respect to these claims under state law. Any  
39 policyholder that funds its own claims under the provisions of  
40 this subdivision shall provide to the guaranty association or to the

1 California Insurance Guarantee Association all relevant  
2 information concerning the claim whenever the policyholder's  
3 reserved liability for the claim equals or exceeds 50 percent of  
4 the deductible amount on the claim.

5 (f) (1) If the insurer has not contractually agreed to allow the  
6 policyholder to fund its own claims within the deductible  
7 amount, to the extent a guaranty association or the California  
8 Insurance Guarantee Association is required by applicable state  
9 law to pay any claims for which the insurer would be or would  
10 have been entitled to reimbursement from the policyholder under  
11 the terms of the deductible agreement, and to the extent the  
12 claims have not been paid by a policyholder or third party, the  
13 liquidator shall promptly bill the policyholder for the  
14 reimbursement. The policyholder shall pay that amount to the  
15 liquidator for the benefit of the California Insurance Guarantee  
16 Association or the guaranty association that paid the claims.  
17 Neither the insolvency of the insurer, nor its inability to perform  
18 any of its obligations under the deductible agreement, shall be a  
19 defense to the policyholder's reimbursement obligation under the  
20 deductible agreement.

21 (2) When the policyholder reimbursements pursuant to  
22 paragraph (1) are collected, the liquidator shall promptly  
23 reimburse the guaranty association or the California Insurance  
24 Guarantee Association for claims paid that were subject to the  
25 deductible. If the policyholder fails to pay the amounts due  
26 within 60 days after the bill for the reimbursements is due, the  
27 liquidator shall use the collateral to the extent necessary to  
28 reimburse the guaranty association or the California Insurance  
29 Guarantee Association, and, at the same time, may pursue other  
30 collections efforts against the policyholder. If more than one  
31 guaranty association or the California Insurance Guarantee  
32 Association has a claim against the same collateral, and the  
33 available collateral, after allocation under subdivision (d), along  
34 with billing and collection efforts, are together insufficient to pay  
35 each guaranty association or the California Insurance Guarantee  
36 Association in full, then the liquidator shall prorate payments to  
37 each guaranty association or the California Insurance Guarantee  
38 Association based upon the relationship the amount of claims  
39 each guaranty association or the California Insurance Guarantee  
40 Association has paid bears to the total of all claims paid by the

1 guaranty association or the California Insurance Guarantee  
2 Association.

3 (g) (1) With respect to claim payments made by any guaranty  
4 association or the California Insurance Guarantee Association,  
5 the liquidator shall promptly provide the court, with a copy to the  
6 guaranty association or the California Insurance Guarantee  
7 Association, with a complete report of the liquidator's deductible  
8 billing and collection activities, including copies of the  
9 policyholder billings when rendered, the reimbursements  
10 collected, the available amounts and use of collateral for each  
11 policyholder, and any proration of payments when it occurs. If  
12 the liquidator fails to make a good faith effort, within 120 days of  
13 receiving a claims payment report, to collect reimbursements due  
14 from a policyholder under a deductible agreement based on claim  
15 payments made by one or more guaranty associations or the  
16 California Insurance Guarantee Association, then the guaranty  
17 association or the California Insurance Guarantee Association  
18 may pursue collection from the policyholders directly on the  
19 same basis as the liquidator, and with the same rights and  
20 remedies, and shall report any amounts so collected from each  
21 policyholder to the liquidator. To the extent that the guaranty  
22 association or the California Insurance Guarantee Association  
23 pays claims within the deductible amount, but is not reimbursed  
24 by the liquidator under this section or by policyholder payments  
25 from the collection efforts of the guaranty association or the  
26 California Insurance Guarantee Association, the guaranty  
27 association or the California Insurance Guarantee Association  
28 shall have a claim against the insolvent insurer's estate for the  
29 unreimbursed claims payments.

30 (2) The liquidator shall periodically adjust the collateral being  
31 held as the claims subject to the deductible agreement are  
32 satisfied, provided that adequate collateral is maintained to  
33 secure the entire estimated ultimate obligation of the  
34 policyholder plus a reasonable safety factor, and provided further  
35 that the liquidator shall not be required to adjust the collateral  
36 more than once a year. The guaranty associations or the  
37 California Insurance Guarantee Association shall be informed of  
38 any collateral adjustment, including but not limited to, the basis  
39 for the adjustment. Once all claims covered by the collateral have  
40 been paid and the liquidator is satisfied that no new claims can be

1 presented, the liquidator shall release any remaining collateral to  
2 the policyholder.

3 (h) The court having jurisdiction over the liquidation  
4 proceedings shall have jurisdiction to resolve disputes arising  
5 under this provision.

6 (i) Nothing in this section is intended to limit or adversely  
7 affect any right a guaranty association or the California Insurance  
8 Guarantee Association may have under applicable state law to  
9 obtain reimbursement from certain classes of policyholders for  
10 claims payments made by the guaranty association or the  
11 California Insurance Guarantee Association under policies of the  
12 insolvent insurer, or for related expenses the guaranty association  
13 or the California Insurance Guarantee Association incur.

14 (j) This section shall apply to any estate for which liquidation  
15 proceedings under this article are in process on January 1, 2006,  
16 and to those estates for whom an order of liquidation is entered  
17 on or after that date.

18 (k) For purposes of this section, the following definitions  
19 apply:

20 (1) "Deductible agreement" means any policy, endorsement,  
21 contract, or security agreement, or a combination of any of those  
22 items, that provides for the policyholder to bear the risk of loss  
23 within a specified amount per claim or occurrence covered under  
24 a policy of insurance, and may be subject to the aggregate limit  
25 of policyholder reimbursement obligations.

26 (2) "Noncovered claim" means a claim that is subject to a  
27 deductible agreement and is not covered by a guaranty  
28 association or the California Insurance Guarantee Association.

29 (l) This section shall apply to claims funded by a guaranty  
30 association or the California Insurance Guarantee Association in  
31 excess of the deductible only if subdivision (e) is applicable.